IN THE
SUPREME COURT OF MISSOURI

No. SC84168

SOUTHWESTERN BELL YELLOW PAGES, INC.

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

Petition For Review
From The Administrative Hearing Commission,
The Honorable Karen Winn, Commissioner

Appellant's Brief

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Table of Contents

Table of Authorities

Cases:

Error! No table of authorities entries found.

Statutes:

Error! No table of authorities entries found.Other:
Error! No table of authorities entries found.

Jurisdictional Statement

The issue in this case is whether a taxpayer is entitled to a refund of use tax that it paid on its purchases of paper outside of Missouri, when it used the paper to make free telephone directories for distribution within Missouri, in fulfillment of the taxpayer's contractual obligations to its advertisers. Because this case involves the construction of the statute imposing the use tax, §144.610, RSMo, a revenue law of this state, this Court has exclusive jurisdiction of this matter. Mo. Const. Art. V, § 3.

Statement of Facts

The parties submitted the case to the Administrative Hearing Commission on a joint stipulation of facts and their respective briefs. The following recitation of facts is drawn from the joint stipulation.

Southwestern Bell Yellow Pages, Inc., the petitioner below, is a corporation authorized to do business in Missouri, with its principal Missouri business office located in St. Louis. LF 12 (¶ 1). Bell's business in Missouri is the publication and distribution of yellow page telephone directories for residential and business use in areas of Missouri where telephone service is provided by Southwestern Bell telephone company. Bell distributes the yellow page telephone directories free of charge. Its main source of revenue from the publication and distribution of the directories in Missouri is from the Missouri businesses that advertise in the directories. LF 13 (¶¶ 3-4).

Bell purchased rolls of blank paper stock from various paper mills located outside of Missouri, for delivery to a printer located outside of Missouri. LF 13 (¶ 5). Bell contracted with the printer to cut, print, and bind the paper into yellow page telephone directories. The printer then shipped Bell's directories to an independent contractor in Missouri, who was employed by and under Bell's direction. The contractor distributed the directories in Missouri. LF 13 (¶¶ 6-7).

Bell self-assessed and paid Missouri use tax on its purchases of the paper outside Missouri. LF 14 (¶ 8). Other than the use tax that Bell paid to Missouri, Bell did not pay any state or local sales or use tax, to any state, on the paper. LF 13 (¶¶ 5-6). The parties do not dispute that Bell does not remit tax on the completed telephone directories.

Bell requested a refund in the amount of $860,832.19, for the periods June 1996 through June 1999. LF 14 (¶¶ 9, 14) and LF 16-17 (Exhibits A, application for refund). As the grounds for its request,

Bell claimed that it had "incorrectly remitted use tax on the original purchase of the paper." LF 17. The Director denied the refund. LF 14 (¶ 10).[1]

The Commission decided that Bell did not owe use tax on its purchase of paper outside of Missouri, because the paper was processed into telephone directories. LF 22; A-4. The Commission agreed with Bell's characterization of the paper as raw material that, like component parts, changed into new, tangible personal property. *Id*.

The Commission recognized that the purpose of the use tax is to protect Missouri revenue, and Missouri sellers, against competition from out-of-state sellers by removing any advantage that might be gained by making purchases outside of Missouri, on which no sales tax is collected, and that in this case, its decision did not fulfill that purpose. LF 23; A-5. The Commission then concluded that Bell may "avoid the incidence of use tax on its yellow pages in Missouri." *Id*. The instant appeal followed.

Point Relied On

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1 Bell's petition also included a refund request for use tax paid on printing charges, plus statutory interest. LF 3. The parties resolved that matter prior to submitting the case to the Commission. LF 14 (¶ 13). Therefore, the only claim that the Commission had before it was Bell's refund claim for the use tax that it paid on the paper.

The Administrative Hearing Commission erred in holding that the taxpayer is owed a refund of use tax for its out-of-state purchases of paper, because the purchase falls within § 144.610, RSMo, in that the taxpayer used the paper to print free telephone directories that it distributed within this state.

R&M Enterprises, Inc. v. Director of Revenue, 748 S.W.2d 171 (Mo. banc 1988)

Farm and Home Savings Assoc. v. Spradling, 538 S.W.2d 313 (Mo. banc 1976)

International Business Machines, Corp. v. David, 408 S.W.2d 833 (Mo. banc 1966)

D.H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24 (1988)

§ 144.610, RSMo (2000)

Standard of Review

Decisions of the Missouri Administrative Hearing Commission are upheld if authorized by law and supported by competent and substantial evidence upon the record as a whole, and when not clearly contrary to the reasonable expectations of the General Assembly. *See Becker Elec. Co. v. Director of Revenue*, 749 S.W.2d 403, 405 (Mo. banc 1988); § 621.193, RSMo. 2000. The Commission's decisions as to questions of law are matters for this Court's independent judgment. *La-Z-Boy Chair Co. v. Director of Economic Development*, 983 S.W.2d 523, 524-25 (Mo. banc 1999); *Hewitt Well Drilling & Pump Service, Inc. v. Director of Revenue*, 847 S.W.2d 797, 797 (Mo. banc 1993).

Argument

The Administrative Hearing Commission erred in holding that the taxpayer is owed a refund of use tax for its out-of-state purchases of paper, because the purchase falls within § 144.610, RSMo, in that the taxpayer used the paper to print free telephone directories that it distributed within this state.

There is no dispute that had Southwestern Bell Yellow Pages purchased its paper in Missouri, the purchase would have been subject to sales tax, pursuant to §144.020, RSMo.[2] Bell should face similar tax consequences, in the form of Missouri use tax, where it buys paper out-of-state. Thus, the issue in this case is whether Bell can avoid tax on the purchase altogether – whether sales or use tax, in Missouri and every other state – by the expedient of purchasing the paper out-of-state, then printing on and binding it, before transporting it into Missouri and distributing it. The Commission's answer should have been no.

The use tax protects Missouri sellers against competition from out-of-state sellers, by removing any advantage that purchasers might gain by making purchases out-of-state – on which Missouri cannot collect sales tax. *R&M Enterprises, Inc. v. Director of Revenue*, 748 S.W.2d 171, 172 (Mo. banc 1988).

The use tax was thus designed to complement the sales tax. *Farm and Home Savings Assoc. v. Spradling*, 538 S.W.2d 313, 317 (Mo. banc 1976). In that vein, it is not a tax on the property itself,

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[2] All statutory references are to the Revised Statutes of Missouri (2000), unless otherwise noted.

but on the privilege of buying or selling the property. *Id, citing Sullivan v. U.S.*, 395 U.S. 169, 175 (1969).

Specifically, §144.610.1 imposes a use tax

> for the privilege of storing, using or consuming within this state any article of tangible personal property purchased ... in an amount equivalent to the percentage imposed on the sales price in the sales tax law in section 144.020. This tax does not apply with respect to the storage, use or consumption of any article of tangible personal property purchased, produced or manufactured outside this state until the transportation of the article has finally come to rest within this state or until the article has become commingled with the general mass of property of this state.

The Court considers statutory terms "in their plain[,] or ordinary and usual sense"; if the statutory terms are "clear and unambiguous, there is no room for construction." *Ryder Student Transp. Svs., Inc. v. Director of Revenue*, 896 S.W.2d 633, 635 (Mo. banc 1996), *citing Jones v. Director of Revenue*, 832 S.W.2d 516, 517 (Mo. banc 1992) and §1.090, RSMo (1994). *See also Lincoln Industrial, Inc. v. Director of Revenue*, 51 S.W.3d 462, 465 (Mo. banc 2001)(same). Dictionary definitions provide the plain meaning of words, unless the legislature has provided statutory definitions. *Lincoln*, at 465. Here, the plain language of the statute, plus the legislature's definition of "use," both discussed below, encompass Bell's purchase.

Paper, of course, falls under the broad umbrella of "any tangible personal property." *See* §144.605(11) (definition of "tangible personal property" for purposes of use tax same as for sales tax, as

provided in §144.020(1) and (3)).

The legislature has provided an equally broad definition of "use," which is

> the exercise of any right or power over tangible personal property incident to the ownership or control of that property, except that it does not include the temporary storage of property in this state for subsequent use outside the state, or the sale of the property in the regular course of business.

§144.605(13).

Bell exercised a right or power over the paper, incident to ownership or control thereof, when it purchased the paper, when it arranged for the paper to be printed upon and bound, when it transported the paper into Missouri, and when it distributed the paper within Missouri. Though Bell in this case used the paper both within and without Missouri, Bell's use of the paper, whether the paper was located within or without Missouri, constituted use within the broad statutory definition of the word. The paper ultimately became subject to Missouri use tax when it was transported into Missouri and delivered to addressees in Missouri, because it had "come to rest within" this state and "become commingled with the general mass of property of this state," either of which condition satisfies §144.610.1. *See R&M Enterprises, Inc. v. Director of Revenue*, 748 S.W.2d 171, 172 (Mo. banc 1988)(asserting even brief privilege of use occasions taxation); *May Dep't Stores Co. v. Director of Revenue,* 748 S.W.2d 174, 177 (Mo. banc 1988) (Robertson, J. dissenting in part) (ownership does not require purchaser to obtain unrestricted use of property at some point in future).[3] The plain language of the statute supports taxability of the paper.

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[3] Further, a few months after the Missouri Supreme Court decided *R&M Enterprises*, the

U.S. Supreme Court decided an analogous case: *D.H. Holmes Co., Ltd. v. McNamara,* 486 U.S. 24 (1988). In *D.H. Holmes,* the Court held that Louisiana did not violate the Commerce Clause when it imposed use tax on catalogs that a Louisiana corporation had printed out-of-state, then mailed directly to individual Louisiana addressees.

But, the Commission did not apply a plain language analysis of §144.610.1. Instead, it essentially began with a discussion of whether Bell was entitled to the component parts exemption, though Bell did not seek a refund on the basis of any exemption. LF 22. Presumably, Bell did not assert the component parts exemption because Bell did not use the yellow paper to produce "new personal property [that] is intended to be sold ultimately for final use or consumption[.]" § 144.030.2(2).[4] Bell neither sold, nor intended to sell, its free telephone directories. Thus, whether the purchase of the paper might qualify for the component parts exemption is irrelevant to the issue that Bell brought before the Commission, which was simply whether its purchase of the paper was subject to Missouri use tax at all.

The Commission also placed weight on Bell's argument that the paper "was consumed and transformed into" telephone directories and thus "never used in Missouri." LF 21; A-3. Both the Commission and Bell cited *International Business Machines, Corp. v. David,* 408 S.W.2d 833 (Mo. banc 1966) (*IBM*), in support. *Id*. In that case, the Court concluded that the use tax applied

> to the completed article ... that is brought into this state and not the items of raw material that went into its manufacture, which, of course, are greatly changed in form and could not be identified as separate articles.

408 S.W.2d at 836 (emphasis added). The Commission's reliance on *IBM* is problematic for two

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[4] Section 144.030.2(2) establishes an exemption for component parts in the sales tax context. Section 144.615(3) incorporates that exemption for purposes of use tax.

reasons: the case is distinguishable, and in any event, it goes too far.

First, the Court held in *IBM* that raw materials – used out-of-state, that were of little value in relation to the (taxable) product sold, and that were both changed in form and were not separately identifiable in the product – were not themselves subject to use tax. *Id*. at 835-836. But in this case, Bell purchased, out-of-state, an article (the paper) that comprised about 50% of the value of the telephone directories. Bell used the paper in Missouri to fulfil its advertising obligations by distributing the completed telephone directories for residential and business use within Missouri; Bell did not sell (or rent) the telephone directories. Unlike the raw materials with little value that the taxpayer used in *IBM* to make machines with a substantial (taxable) rental value, the paper that Bell purchased was not substantially changed in form, and comprised about half of the value of the free directories. Therefore, contrary to the Commission's holding, *IBM* does not support Bell's refund in this case.

Moreover, this Court in *IBM* did not reach a holding that permitted the company to escape tax altogether in the stream. The company was still liable for tax on its rentals of the equipment. *IBM*, at 837. But in this case, the taxpayer would stretch *IBM* beyond its holding to do just that - escape tax all along the stream, in Missouri and the foreign state. *IBM* should not be read so broadly.

Bell did make an argument below that the taxpayer did not make in *IBM*: that the paper was raw material that lost its identity when it was manufactured into telephone directories outside Missouri, and therefore was never used in Missouri. The Commission agreed, citing *Morton Buildings, Inc. v. Director of Revenue,* 1989 Mo. Tax LEXIS 138, No. 88-001879 RZ (AHC Dec. 8, 1989), in the same vein that it cited *IBM*. LF 22-23. In *Morton,* the taxpayer avoided use tax on raw materials such as lumber, sheeting, and nails, that it used out-of-state to manufacture pre-fabricated building components.

The Commission held that the raw materials "[lost] their individual identities and [became] part of a manufactured product." *Id*. at *12-13.

But here, the paper was not "raw material," such as wood pulp, that was unidentifiable in, or had otherwise disappeared in the course of, manufacture of the telephone directories. The paper that Bell purchased retained its identity as paper even after it was cut, printed upon, and bound. The very reason that Bell used that yellow paper – instead of cassette tapes, video tapes, white paper, white card stock, floppy disks, or semaphore – is that Bell had contracted with its advertisers to put the advertisers' information onto an accessible, simple, visual, and distinctive medium – the special yellow paper. Had Bell used anything but that paper, it presumably would not have been fulfilling its contractual obligations, because an integral part of that contractual obligation involved the paper retaining its identity as such. Therefore, the Commission should have rejected Bell's "raw material" argument.

Second, the *IBM* decision itself goes too far. The decision patently inserts the word "completed" in front of the word "article" (which appears in both the first and second sentences of the statute). *IBM,* at 836 ("[O]ur use tax applies to the completed article[.]"). The Court thus effectively defeated the purpose of protecting Missouri revenue and Missouri sellers against out-of-state competition. With respect to the first sentence of the statute, the added word gives an advantage to a business that would purchase articles of tangible personal property out-of-state for further manufacturing or production out-of-state and that brings the completed article into Missouri for storage, use, or consumption with no tax incurred. The intent of the legislature in establishing the use tax as a complement to the sales tax was to avoid precisely that unfair advantage. *R&M Enterprises,* 748 S.W.2d at 172; *Farm & Homes Savings Association,* 538 S.W.2d at 317. But as it stands, the Commission's decision is an invitation for

businesses to do precisely what Bell has done, so as to avoid tax in both Missouri and the foreign state.

The second sentence of §144.610.1 describes the application of the tax:

> The tax does not apply with regard to the storage, use or consumption of any article of tangible personal property purchased, produced or manufactured outside this state until the transportation of the article has finally come to rest within this state or until the article has become commingled with the general mass of property of this state.

By inserting the word "completed" in front of the word "article" in this sentence, the Court rendered meaningless the statutory terms "produced" and "manufactured" that follow. If the use tax applies only to items that are purchased as completed articles, then it does not matter whether the article is "produced" or "manufactured," only that the completed article is "purchased." Making the words "produced" and "manufactured" meaningless by inserting "completed" in the second sentence of the statute defeats the function of the use tax as much as inserting the word "completed" into the first sentence of the statute.

Further, the legislature used the word "any" in the second sentence, as in, "any articles of tangible personal property." "Any" is obviously a broad word. *See* WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (1993) (defining "any" as "1: one indifferently out of more than two . . . a: one or another . . . b: one no matter what one; EVERY . . . 3a: great, unmeasured, or unlimited in amount, quantity, number, time or extent . . . ."). The word "any" ensures that the statute casts the broadest net that it can in applying the use tax, dovetailing with the inclusion of the words "purchased, produced or manufactured," which also cast a broad net.

The legislature purposely used the phrase, "any article of tangible personal property purchased,

produced or manufactured." To give effect to the phrase, in full and as written, the use tax must be imposed on any articles of tangible personal property that are purchased, produced or manufactured outside of the state, in the same manner as the sales tax would be imposed where the same activities occurred within the state. *See Ryder Student Transp. Svs. Inc. v. Director of Revenue*, 896 S.W.2d 633, 635 (Mo. banc 1995) ("[C]ourt cannot resort to canons of construction to add words to [a] statute which are not there."). This is not the same as a "completed" article for sale. To the extent that *IBM* says otherwise, it should be modified.

Finally, the Commission concluded that *IBM* and *May Department Stores, Co. v. Director of Revenue*, 748 S.W.2d 174 (Mo. banc 1988), allow Bell "to avoid the incidence of use tax on its yellow pages in Missouri." LF 23. But the issue in this case is not whether Bell may avoid use tax on the telephone directories. Bell neither intends to nor actually sells them, and the Director does not seek to tax the total cost of the directories.

In view of the foregoing, the Commission's decision utterly misconstrues the law. The *IBM* case also goes too far as applied. The Commission's decision should be reversed, and Bell's refund denied.

Conclusion

The decision of the Administrative Hearing Commission should be reversed, and the Director's denial of Bell's request for refund should be affirmed.

Respectfully submitted,

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Certification of Service and of Compliance with Rule 84.06(b) and (c)

The undersigned hereby certifies that on this 1st day of April, 2002, one true and correct copy of the foregoing brief, and one disk containing the foregoing brief, were mailed, postage prepaid, to:

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The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b), and that the brief contains 3,532 words.

The undersigned further certifies that the labeled disk, simultaneously filed with the hard copies of the brief, has been scanned for viruses and is virus-free.

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Alana M. Barragán-Scott

Appendix